

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE
DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

October 1, 2001 through September 30, 2003

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:

<http://audgen.michigan.gov>



Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

*Including the Provisions of the Single Audit Act
October 1, 2001 through September 30, 2003*

Department of Military and Veterans Affairs

Report Number:
51-100-04

Released:
June 2004

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Schedules:

Auditor's Report Issued

We issued an unqualified opinion on the Department of Military and Veterans Affairs' (DMVA's) financial schedules.

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Internal Control Over Financial Reporting

We did not identify any material weaknesses in internal control over financial reporting. However, we did identify a reportable condition (Finding 1).

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Noncompliance Material to the Financial Schedules

We did not identify any instances of noncompliance applicable to the financial schedules that are required to be reported under *Government Auditing Standards*.

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 2 programs as major programs and issued 2 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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Internal Control Over Major Programs

We did not identify any material weaknesses in internal control over major programs. However, we did identify a reportable condition (Finding 2).

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We identified an instance of noncompliance that is required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Finding 2).

~ ~ ~ ~ ~

Systems of Accounting and Internal Control:

We determined that DMVA was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

~ ~ ~ ~ ~

We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
12.401	National Guard Military Operations and Maintenance Projects	Unqualified
12.404	National Guard Civilian Youth Opportunities	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 30, 2004

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Military and Veterans Affairs (DMVA) for the period October 1, 2001 through September 30, 2003.

This report contains our report summary; our independent auditor's report on the financial schedules; and the DMVA financial schedules, notes to the financial schedules, and supplemental financial schedules. This report also contains our independent auditor's reports on compliance and on internal control over financial reporting and on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133 and our schedule of findings and questioned costs. In addition, this report contains DMVA's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency's preliminary response is contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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TABLE OF CONTENTS

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT AND FINANCIAL SCHEDULES	
Independent Auditor's Report on the Financial Schedules	8
Department of Military and Veterans Affairs Financial Schedules	
Schedule of General Fund Revenues	10
Schedule of Sources and Disposition of General Fund Authorizations	11
Notes to the Financial Schedules	12
SUPPLEMENTAL FINANCIAL SCHEDULES	
Schedule of Disposition of General Fund Authorizations by Appropriation Unit	18
Schedule of Expenditures of Federal Awards	20
Notes to the Schedule of Expenditures of Federal Awards	22
INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE AND INTERNAL CONTROL	
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting	24

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	26
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results	30
Section II: Findings Related to the Financial Schedules	31
1. Recording of Expenditures	31
Section III: Findings and Questioned Costs Related to Federal Awards	32
2. Federal Payroll Costs	32

OTHER SCHEDULES

Summary Schedule of Prior Audit Findings	35
Corrective Action Plan	36

GLOSSARY

Glossary of Acronyms and Terms	39
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INDEPENDENT AUDITOR'S REPORT AND FINANCIAL SCHEDULES



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

April 9, 2004

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

We have audited the financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2003 and September 30, 2002, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1b, the financial schedules include only the revenues and the sources and disposition of authorizations for the Department of Military and Veterans Affairs' General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in accordance with accounting principles generally accepted in the United States of America.

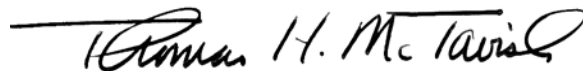
In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and the sources and disposition of authorizations of

the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2003 and September 30, 2002, on the basis of accounting described in Note 1b.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 9, 2004 on our tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the other supplemental financial schedule, the schedule of disposition of General Fund authorizations by appropriation unit, are presented for purposes of additional analysis and are not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.
Auditor General

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of General Fund Revenues
Fiscal Years Ended September 30

	<u>2003</u>	<u>2002</u>
REVENUES		
Federal Revenues:		
National Guard Bureau	\$ 24,020,731	\$ 23,551,543
Veterans Administration State Home Program	17,025,819	16,619,349
Medicare and Medicaid	1,719,949	1,507,843
Department of Education	150,168	196,213
Total Federal Revenues	<u>\$ 42,916,667</u>	<u>\$ 41,874,948</u>
Cost-of-care assessments	18,791,125	18,264,043
Armory Rental Program	156,560	67,824
Armory sales	62,000	
Miscellaneous	<u>57,337</u>	<u>167,619</u>
Total Revenues	<u><u>\$ 61,983,689</u></u>	<u><u>\$ 60,374,434</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	<u>2003</u>	<u>2002</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations (Note 1c)	\$ 38,378,308	\$ 40,346,100
Budgetary adjustment	7,783	9,521
Balances carried forward (Note 3)	4,885,807	3,617,834
Restricted financing sources	<u>61,615,772</u>	<u>60,257,736</u>
 Total	 <u><u>\$ 104,887,670</u></u>	 <u><u>\$ 104,231,191</u></u>
 DISPOSITION OF AUTHORIZATIONS (Note 2)		
Expenditures and transfers out	<u>\$ 98,428,429</u>	<u>\$ 98,549,249</u>
Balances carried forward:		
Multi-year projects	\$ 225,806	\$
Encumbrances	97,118	534,089
Restricted revenues - authorized	466,613	543,434
Restricted revenues - not authorized	4,915,870	3,887,292
Total balances carried forward	<u>\$ 5,705,407</u>	<u>\$ 4,964,815</u>
Balances lapsed	<u>\$ 753,834</u>	<u>\$ 717,128</u>
 Total	 <u><u>\$ 104,887,670</u></u>	 <u><u>\$ 104,231,191</u></u>

The accompanying notes are an integral part of the financial schedules.

Notes to the Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial schedules report the results of the financial transactions of the Department of Military and Veterans Affairs (DMVA) for the fiscal years ended September 30, 2003 and September 30, 2002. The financial transactions of DMVA are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. In addition, DMVA is responsible for the supervision and direction of the Michigan Veterans' Trust Fund. The Fund provides grants to assist veterans and their dependents. The Fund also provides administrative support for the Vietnam Veterans' Memorial Monument Fund. These Funds periodically receive separate financial and performance audits and are not included in the scope of this audit because federal funds are not received or expended.

The notes accompanying these financial schedules relate directly to DMVA. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies; Budgeting, Budgetary Control, and Legal Compliance; and Pension Benefits and Other Postemployment Benefits.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by generally accepted accounting principles applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial schedules present only the revenues and the sources and disposition of authorizations for DMVA's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either DMVA or the State's General Fund in conformity with generally accepted accounting principles.

c. Military Retirement Benefits

DMVA received annual appropriations for military retirement benefits for the Michigan National Guard members and special duty officers. These appropriations are made from the General Fund on a pay-as-you-go basis. Expenditures for the military retirement plan totaled \$2,610,598 for fiscal year 2002-03 and \$2,409,900 for fiscal year 2001-02. The actuarially determined unfunded liabilities for the military retirement plan as of September 30, 2003 totaled \$40.4 million.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.
- b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized.
- c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next

fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized. Restricted financing sources include federal revenue and cost-of-care assessments.

- d. Multi-year projects: Unexpended authorizations for work projects and capital outlay projects that are carried forward to subsequent fiscal years for the completion of the projects. In addition to the amounts recorded in the financial schedules, DMVA also had authorizations for large capital outlay projects that were accounted for by the Department of Management and Budget (DMB). Unexpended authorizations carried forward for projects accounted for by DMB totaled \$47,816,516 for fiscal year 2002-03 and \$50,640,036 for fiscal year 2001-02.
- e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- f. Restricted revenues - authorized: Revenues that, by statute, are restricted and authorized for use to a particular program or activity. Generally, the expenditure of the restricted revenue is subject to annual legislative appropriation. However, the restricted revenue may also be used in subsequent years to finance expenditures in multi-year appropriations and for encumbrances carried forward. DMVA has restricted revenue from the sale of land owned by DMVA.
- g. Restricted revenues - not authorized: Revenues that, by statute, are restricted for use to a particular program or activity. However, DMVA had not received legislative authorization to expend the revenues. DMVA's fiscal year 2002-03 significant carry-forwards of this type were for revenues collected by the Grand Rapids and D.J. Jacobetti Homes for Veterans for cost-of-care assessments (\$2,145,570) and the U.S. Department of Veterans Affairs' federal assistance (\$2,768,433).
- h. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 3 Balances Carried Forward - Authorized

DMVA's Armory Construction Fund, within the General Fund, collects and maintains revenue restricted for funding State armory capital outlay projects with authorization to carry forward unspent revenue to the next fiscal year. Armory capital outlay projects are primarily appropriated within DMB's Office of Design and Construction (ODC) accounts. DMVA transfers cash to ODC to cover construction costs throughout the year. When ODC's current year funding is not sufficient to fund current year expenditures, DMVA transfers cash from the Armory Construction Fund's restricted revenue collected in prior years. This transfer reduces the beginning balance carried forward from the prior year for DMVA but increases DMB's carried forward balance. As a result, the amount shown for ending balances carried forward for DMVA is \$79,008 greater than the amount shown for beginning balances carried forward in the next fiscal year on the schedule of sources and dispositions of General Fund authorizations.

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SUPPLEMENTAL FINANCIAL SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Disposition of General Fund Authorizations by Appropriation Unit
Fiscal Years Ended September 30

Appropriation Unit	2003				
	Total Authorizations	Appropriation Transfers	Expenditures and Transfers Out	Balances Carried Forward	Balances Lapsed
Headquarters and armories	\$ 13,682,369	\$ (765,300)	\$ 12,578,073	\$ 231,696	\$ 107,300
Military training sites and support facilities	17,138,257	(130,000)	16,978,756		29,501
Departmentwide support	9,725,424	1,268,500	10,408,469	535,752	49,703
Veterans service organizations	3,912,300		3,912,200		100
Grand Rapids Home for Veterans	43,788,297	(257,400)	41,438,066	1,694,210	398,622
D.J. Jacobetti Home for Veterans	16,268,990	(65,800)	12,790,832	3,243,750	168,608
Michigan Veterans' Trust Fund	344,200	(50,000)	294,200		
Vietnam Veterans' Memorial Monument Fund	20,051		20,051		
Accounts receivable write-offs	<u>7,783</u>		<u>7,783</u>		
Total	<u>\$ 104,887,670</u>	<u>\$ 0</u>	<u>\$ 98,428,429</u>	<u>\$ 5,705,407</u>	<u>\$ 753,834</u>

2002				
Total Authorizations	Appropriation Transfers	Expenditures and Transfers Out	Balances Carried Forward	Balances Lapsed
\$ 13,983,147	\$ (135,000)	\$ 13,435,879	\$ 40,690	\$ 371,579
15,753,930	100,000	15,850,472		3,458
10,984,146	35,000	10,246,878	708,558	63,711
3,884,400		3,884,300		100
43,279,894		41,512,223	1,626,438	141,234
15,582,220		12,909,704	2,569,079	103,436
352,429		318,820		33,610
401,504		381,454	20,051	
9,521		9,521		
<u>\$ 104,231,191</u>	<u>\$ 0</u>	<u>\$ 98,549,249</u>	<u>\$ 4,964,815</u>	<u>\$ 717,128</u>

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Expenditures of Federal Awards *
For the Period October 1, 2001 through September 30, 2003

		For the Fiscal Year Ended September 30, 2002				
Federal Agency/Program	CFDA ** Number	Pass-Through Identification Number	Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	Total Expended, Distributed, and In-Kind Assistance
<u>U.S. Department of Agriculture</u>						
Direct Program:						
Schools and Roads - Grants to Counties	10.666					
Total U.S. Department of Agriculture						
<u>U.S. Department of Defense</u>						
Direct Programs:						
National Guard Military Operations and Maintenance Projects:						
Appendix 1 Army National Guard Real Property Operations and Maintenance (Note 2)	12.401		\$ 14,532,128	\$	\$ 92,500	\$ 14,624,628
Appendix 2 Army National Guard Environmental and Integrated Training Area Resources Management	12.401		1,797,997		684,352	2,482,349
Appendix 3 Army National Guard Security Guard Activities	12.401		529,536			529,536
Appendix 4 Army National Guard Electronic Security System Operation and Maintenance	12.401		193,271			193,271
Appendix 5 Army National Guard Telecommunications	12.401		719,766			719,766
Appendix 6 Army National Guard Aviation Training Base Operations	12.401		33,420			33,420
Appendix 7 Army National Guard Range and Training Land Program	12.401		273,147			273,147
Appendix 9 Army National Guard Store Front Recruiting Office Lease	12.401		122,610			122,610
Appendix 21 Air National Guard Facilities Operations and Maintenance Activities	12.401		2,496,097		2,656,719	5,152,816
Appendix 22 Air National Guard Environmental Program Management	12.401		114,644			114,644
Appendix 23 Air National Guard Security Guard Activities	12.401		1,347,832		75,849	1,423,681
Appendix 24 Air National Guard Fire Protection Activities	12.401		2,707,701		79,199	2,786,900
Appendix 40 Army National Guard Distance Learning Project	12.401		94,437			94,437
Total National Guard Military Operations and Maintenance Projects			<u>\$ 24,962,586</u>	<u>\$ 0</u>	<u>\$ 3,588,619</u>	<u>\$ 28,551,205</u>
National Guard Civilian Youth Opportunities:						
Challenge Program	12.404		\$ 1,618,401	\$	\$	\$ 1,618,401
Starbase Program	12.404			771,593		771,593
Total National Guard Civilian Youth Opportunities			<u>\$ 1,618,401</u>	<u>\$ 771,593</u>	<u>\$ 0</u>	<u>\$ 2,389,994</u>
Total U.S. Department of Defense			<u>\$ 26,580,987</u>	<u>\$ 771,593</u>	<u>\$ 3,588,619</u>	<u>\$ 30,941,199</u>
<u>U.S. Department of Veterans Affairs</u>						
Direct Programs:						
Veterans State Domiciliary Care	64.014		\$ 1,021,805	\$	\$	\$ 1,021,805
Veterans State Nursing Home Care	64.015		14,271,894			14,271,894
Total U.S. Department of Veterans Affairs (Note 3)			<u>\$ 15,293,699</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 15,293,699</u>
<u>U.S. Department of Education</u>						
Pass-Through Program:						
Michigan Department of Community Health						
Safe and Drug-Free Schools and Communities - State Grants	84.186	MYC2000	\$ 196,213	\$	\$	\$ 196,213
Total U.S. Department of Education			<u>\$ 196,213</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 196,213</u>
Total Expenditures of Federal Awards			<u>\$ 42,070,899</u>	<u>\$ 771,593</u>	<u>\$ 3,588,619</u>	<u>\$ 46,431,111</u>

* Basis of Presentation: This schedule includes the federal grant activity of the Department of Military and Veterans Affairs and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules.

** CFDA is defined as the *Catalog of Federal Domestic Assistance*.

The accompanying notes are an integral part of this supplemental financial schedule.

For the Fiscal Year Ended September 30, 2003

Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	Total Expended, Distributed, and In-Kind Assistance	Total Expended, Distributed, and In-Kind Assistance for the Two-Year Period
\$	\$ 114,300	\$	\$ 114,300	\$ 114,300
\$ 0	\$ 114,300	\$ 0	\$ 114,300	\$ 114,300
\$ 18,223,577	\$	\$ 932,900	\$ 19,156,477	\$ 33,781,105
2,223,981		1,389,375	3,613,356	6,095,705
912,118			912,118	1,441,654
98,462			98,462	291,733
715,717			715,717	1,435,483
42,920			42,920	76,340
267,457			267,457	540,604
108,864			108,864	231,474
2,872,445		3,052,242	5,924,687	11,077,503
124,354			124,354	238,998
1,405,384		25,025	1,430,409	2,854,090
3,143,538		127,889	3,271,427	6,058,327
88,933			88,933	183,370
\$ 30,227,750	\$ 0	\$ 5,527,431	\$ 35,755,181	\$ 64,306,386
\$ 1,693,549	\$ 598,752	\$	\$ 1,693,549	\$ 3,311,950
			598,752	1,370,345
\$ 1,693,549	\$ 598,752	\$ 0	\$ 2,292,301	\$ 4,682,295
\$ 31,921,299	\$ 598,752	\$ 5,527,431	\$ 38,047,482	\$ 68,988,681
\$ 1,109,823	\$	\$	\$ 1,109,823	\$ 2,131,628
14,964,805			14,964,805	29,236,699
\$ 16,074,628	\$ 0	\$ 0	\$ 16,074,628	\$ 31,368,327
\$ 149,996	\$	\$	\$ 149,996	\$ 346,209
\$ 149,996	\$ 0	\$ 0	\$ 149,996	\$ 346,209
\$ 48,145,923	\$ 713,052	\$ 5,527,431	\$ 54,386,406	\$ 100,817,517

Notes to the Schedule of Expenditures of Federal Awards

Note 1 In-Kind Assistance

As part of the National Guard Bureau Cooperative Agreement, the U.S. Department of Defense also provided in-kind assistance in the form of direct federal payment for services and supplies for the military operations and maintenance projects.

Note 2 Transfers for Capital Outlay Projects

This schedule includes the cost of military operations and maintenance projects that are administered by the Office of Design and Construction, Department of Management and Budget (DMB). In accordance with State accounting policy, these costs are recorded as expenditures by DMB. The Department of Military and Veterans Affairs (DMVA) requests and receives reimbursement from the National Guard Bureau, U.S. Department of Defense, and transfers the related revenue to a DMB federal revenue account. However, because DMVA is responsible for federal compliance related to these projects, the expenditures have been recorded as directly expended by DMVA on this schedule. The transfers totaled \$3,801,026 in fiscal year 2001-02 and \$8,480,867 in fiscal year 2002-03.

Note 3 Medicare and Medicaid Revenue

The Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans received federal Medicare revenue totaling \$862,252 in fiscal year 2001-02 and \$882,995 in fiscal year 2002-03. The Grand Rapids Home for Veterans received federal Medicaid revenue totaling \$632,913 in fiscal year 2001-02 and \$499,999 in fiscal year 2002-03. Medicare and Medicaid revenue is not considered federal assistance, but rather a purchase of services provided by the Homes. Therefore, Medicare and Medicaid revenue is not included in this schedule.

INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE AND INTERNAL CONTROL



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

April 9, 2004

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

We have audited the financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2003 and September 30, 2002, as identified in the table of contents, and have issued our report thereon dated April 9, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and not to provide assurance on internal control over financial reporting. However, we noted a matter involving internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to initiate,

record, process, and report financial data consistent with the assertions of management in the financial schedules. The reportable condition is described in the accompanying schedule of findings and questioned costs as Finding 1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition identified in the previous paragraph is not a material weakness.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal line extending from the start of the name.

Thomas H. McTavish, C.P.A.
Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

April 9, 2004

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

Compliance

We have audited the compliance of the Department of Military and Veterans Affairs with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each major federal program for the two-year period ended September 30, 2003. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our

opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of Military and Veterans Affairs complied, in all material respects, with the requirements referred to in the second previous paragraph that are applicable to each major federal program for the two-year period ended September 30, 2003. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding 2.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted a matter involving internal control over compliance and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable condition is described in the accompanying schedule of findings and questioned costs as Finding 2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over compliance would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition identified in the previous paragraph is not a material weakness.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal line extending from the start of the name.

Thomas H. McTavish, C.P.A.
Auditor General

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Schedules

Type of auditor's report issued: Unqualified*

Internal control* over financial reporting:

Material weaknesses* identified? No

Reportable condition* identified that is not considered to be a material weakness? Yes

Noncompliance material to the financial schedules? No

Federal Awards

Internal control over major programs:

Material weaknesses identified? No

Reportable condition identified that is not considered to be a material weakness? Yes

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)? Yes

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
12.401	National Guard Military Operations and Maintenance Projects
12.404	National Guard Civilian Youth Opportunities

Dollar threshold used to distinguish between type A and type B programs: \$3,000,000

Auditee qualified as a low-risk auditee*? No

* See glossary at end of report for definition.

Section II: Findings Related to the Financial Schedules

FINDING (510401)

1. Recording of Expenditures

The Department of Military and Veterans Affairs' (DMVA's) internal control did not ensure that expenditures were recorded in the proper fiscal year and that supporting documentation was retained. Although the resulting error amounts were not material to the financial schedules, a procedure to review and record payments in the proper fiscal year could prevent potentially significant errors in the future. Our review of DMVA expenditures disclosed:

- a. During our audit period, 7 (7%) of 100 expenditure transactions sampled, totaling \$10,182, were not recorded in the proper fiscal year. In 5 of the 7 instances, goods and services and an invoice or agreement were received in the same year, but DMVA recorded the entry in the wrong fiscal year. In 2 of the 7 instances, travel expenditures were not properly allocated between fiscal years. However, in the instances noted, the proper fiscal year was identifiable and the invoices were received within a time frame that would have allowed for proper recording.
- b. The Grand Rapids Home for Veterans was unable to locate support for 3 (5%) of 59 expenditure documents sampled. Supporting documentation should be retained to verify that the accounting transactions were recorded for the correct amount and in the proper account and proper fiscal year. The missing documents totaled \$7,193.

RECOMMENDATION

We recommend that DMVA improve its internal control over recording expenditures in the proper fiscal year and maintaining expenditure supporting documentation.

The status of the findings related to the financial schedules that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (510402)

2. Federal Payroll Costs

U.S. Department of Defense	CFDA 12.401: National Guard Military Operations and Maintenance Projects
Award Number: DAHA20-99-2-1000	Award Period: 07/09/1999 - 07/08/2004
	Questioned Costs: \$114,967

U.S. Department of Defense	CFDA 12.404: National Guard Civilian Youth Opportunities
Award Number: DAHA20-99-2-4000	Award Period: 07/09/1999 - 07/08/2004
	Questioned Costs: \$21,092

DMVA charged terminal leave costs for two federal programs and exceeded hourly federal pay rate limits for one federal program. As a result, we questioned \$136,059 of the \$22.7 million in payroll costs charged to these federal programs for the two-year period.

Our review of DMVA's payroll costs charged to federal programs disclosed:

- a. For the two-year period, DMVA charged, as direct federal expenditures, terminal leave payments of \$114,967 to the National Guard Military Operations and Maintenance Projects and \$12,420 to the National Guard Civilian Youth Opportunities. OMB Circular A-87 prohibits the direct charging of terminal leave payments, at the time of separation, to federal programs unless the state obtains prior approval from the federal awarding agency. OMB Circular A-87 does allow for these types of charges through an indirect cost rate. However, National Guard Regulation 5-1/ANGI 63-101 Section 5-4 states that indirect costs, such as those defined in OMB Circular A-87, are unallowable. It further states that, except for fringe benefits, Congress has not authorized the National Guard Bureau to reimburse indirect costs.

* See glossary at end of report for definition.

DMVA informed us that because these types of payments have been accepted and approved for payment by the United States Property and Fiscal Office (USPFO) representative in Michigan in the past, it believed that the terminal leave payments were properly charged to the grants.

- b. DMVA requested and received reimbursement for certain Michigan Youth Challenge Program* (ChalleNGe Program) employees using pay rates that exceeded specific wage limits, totaling \$8,672 for the two-year period.

The Youth Programs Cooperative Agreement specifies wage limits for ChalleNGe Program employees based on position. During the two-year period, DMVA charged payroll costs to the ChalleNGe Program based on hourly pay rates determined by the Michigan Department of Civil Service. In some instances, these hourly pay rates exceeded the federal authorized wage limits. The Youth Programs Cooperative Agreement allows DMVA to request approval for an exception to the wage limitation; however, DMVA did not submit a request.

A similar exception was noted in a USPFO audit of the ChalleNGe Program. As a result of that audit, DMVA corrected the error for the program year July 9, 2002 through July 8, 2003; however, DMVA has not made an adjustment for the remaining portion of our audit period (October 2001 through June 2002 and August 2003 and September 2003). DMVA informed us that it would adjust the charges for August 2003 and September 2003 at the end of the program year in July 2004.

RECOMMENDATIONS

We recommend that DMVA not charge unauthorized terminal leave costs or exceed hourly federal pay rate limits for its federal programs.

We also recommend that DMVA seek clarification from the National Guard Bureau, U.S. Department of Defense, regarding terminal leave costs.

* See glossary at end of report for definition.

OTHER SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Summary Schedule of Prior Audit Findings
As of September 30, 2003

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 1999 through September 30, 2001
Finding Number: 510201
Finding Title: Internal Auditor Independence

Finding: The Department of Military and Veterans Affairs' (DMVA's) internal auditor was not organizationally independent.

Comments: The internal auditor will report to DMVA's director.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards in the prior Single Audit.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

Corrective Action Plan

As of June 21, 2004

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 510401

Finding Title: Recording of Expenditures

Management Views: The Department of Military and Veterans Affairs (DMVA) agrees with the recommendation in Finding 510401.

Corrective Action: Part a. DMVA (Office of Financial Services) will continue to review all payments in the future and break out all expenditures between fiscal years.

Part b. DMVA will increase its efforts to maintain all expenditure documentation in the future.

Anticipated Completion Date: During the fiscal year 2003-04 year-end closing period

Responsible Individual: Joel Wortley, DMVA Chief Financial Officer

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 510402

Finding Title: Federal Payroll Costs

Management Views: DMVA agrees with the recommendations in Finding 510402.

Corrective Action: Part a. DMVA has discussed the issue with the United States Property and Fiscal Office (USPFO) for

Michigan and together we are researching the issue with legal and other program staff in the Washington, D.C., office.

Part b. DMVA is continuing to monitor expenditures and will adjust the charges for August 2003 and September 2003 at the end of budget year 5 in July 2004.

Anticipated Completion Date: September 30, 2004

Responsible Individual: Joel Wortley, DMVA Chief Financial Officer

GLOSSARY

Glossary of Acronyms and Terms

CFDA	<i>Catalog of Federal Domestic Assistance.</i>
DMB	Department of Management and Budget.
DMVA	Department of Military and Veterans Affairs.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the results of operations or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.

material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
Michigan Youth ChalleNGe Program (ChalleNGe Program)	A program directed at "at risk" youth funded with State General Fund and federal National Guard (NG) funds.
ODC	Office of Design and Construction.
OMB	U.S. Office of Management and Budget.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in

accordance with the applicable requirements of laws, regulations, contract, and grants.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments for 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply

auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or

- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

USPFO

United States Property and Fiscal Office.